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# **The Political Economy of Pro-Poor Growth**

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## **ABSTRACT**

Can the PRSP process enhance pro-poor growth in developing countries? This question is addressed in a politico-economic framework considering political distortions both on the recipient and on the donor side. It turns out that PRSP processes can be a very useful tool to enhance pro-poor growth and to raise the welfare of the poor. This is the case if the international aid organizations have all necessary information to assess the political situation in recipient countries and to select the true representatives of the poor into the process. If they do not hold this information or if bureaucratic interests and public pressure reduce their incentive to obtain or use this information, PRSPs lose their effectiveness in achieving the desired objective.

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## 1. INTRODUCTION

According to the World Bank's Research Paper on the "Role and Effectiveness of Development Assistance" (Goldin, Rogers and Stern 2002), development co-operation admittedly showed some failures in the past, but has worked much better since the end of the Cold War and is still constantly improving due to a deepened focus on poverty and an increased emphasis on local ownership and broad based participation.

The centerpiece of this improved development assistance is the elaboration of Poverty Reduction Strategy Papers (PRSPs) which have become a precondition for debt relief under the enhanced Highly Indebted Poor Countries (HIPC) initiative and other forms of concessional financing. International Financial Institutions (IFIs) and other donors expect that this approach will significantly contribute to the objective of reducing poverty by half in 2015 codified in the "Millennium Goals" of the international donor community (see OECD 2001). In particular, PRSPs are supposed to enhance "pro-poor-growth", a recently coined term indicating growth predominantly benefiting the poor.

This optimistic view is far from being shared by all observers of the development process. In this paper, we question the originality of the objective of "pro-poor-growth" and analyze the chances of success of the PRSP process from a politico-economic perspective. Thereby we explicitly focus on the interactions between the politico-economic aspects of recipient and donor policies.

Based on Mayer and Mourmoura's (2002) model of IFI conditionality, we show that with a well informed and benevolent IFI, conditioning aid on PRSP processes can be a promising alternative to traditional conditionality. The policy in the recipient country can be induced to shift towards higher support for pro-poor growth through enhanced national ownership of this policy. However, if bureaucratic interest within the IFI and pressure from bilateral donors and international NGOs are taken into account, this outcome becomes much harder to achieve.

Our approach is influenced by the theoretical literature on the political economy of aid. While there is considerable literature on the political economy in developing countries, and some literature on donor behavior (see e.g. Vaubel and Willet 1991, Kaltefleiter 1995, Michaelowa 1998, Frey 1997, Willet 2000, Lahiri, Raimondos-Møller 2000 and Michaelowa 2003)<sup>1</sup>, the literature combining both aspects is rather limited. Martens et al. (2002) and Azam and Laffont (2003) are two recent exceptions. With this paper, we hope to add some useful insight by stressing the interaction of non-benevolent behavior on both sides.

The paper is structured as follows: In section 2, we discuss to what extent the objective of "pro-poor-growth" and the PRSP approaches promoted by the IFIs can be considered to be really new and original. In section 3 a basic politico-economic model will be outlined, and the effects of both traditional development assistance and assistance in the context of the PRSP processes will be compared. Section 4

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<sup>1</sup> For a general overview over the literature on the political economy of development co-operation, see Drazen (2000).

introduces the IFI's own bureaucratic interest and public pressures. Section 5 concludes.

## 2. WHAT IS NEW ABOUT "PRO-POOR GROWTH"?

While the broad international agreement on the objective of "pro-poor growth" and its operationalization through PRSP processes is considered as a significant step towards efficient development co-operation by the IFIs, it does not raise similarly optimistic expectations elsewhere.

The objective is certainly laudable - but what is really new about it? Some observers of the process have come to ask whether it is the rhetoric, rather than anything else, that is really new. "*Old wine in new bottles?*" is the characteristic title of a recent paper examining the issue in the context of the PRSP approach (Cling, Razafindrakoto and Roubaud 2002).

The author stressing most clearly that at least the objective as such is not new is William Easterly, himself a former economist at the World Bank. Under the title "*Plus ça change, plus c'est la même chose*", he presents a table with the history of aid policy directions at the Bank. The emphasis on poverty reduction evolved from "far greater" in the early 1970s to "even stronger" in 1990, and is now finally "increasing" in the new millennium (Easterly 2002, p. 35, quoting McNamara 1973, World Bank 1990 and IDA 2001). Similarly, ownership has long been accepted as a relevant precondition for the sustainability of development efforts. Under various titles such as "partnership", "beneficiary participation", "community-driven development (CDD)", "empowering the poor", "consultation of stakeholders" and "bottom up development" the issue has been discussed since the early 1960s (Easterly 2002, p. 42).

Easterly argues that the aid bureaucracy has an incentive to obfuscate the inefficiencies and failures of the past and to protect itself against criticism by continuously emphasizing desirable "new" goals. Therefore: "*Like laundry detergent, aid is always 'new and improved'*" (Easterly 2002, p. 34). Since there are no really improved strategies to offer, old strategies are sold under new labels, and traditional objectives are periodically reinvented. From Easterly's sobering point of view, despite all rhetoric, the chances for pro-poor growth under PRSP processes are thus not really higher than they were ever before (Easterly 2002, p. 43).

Who is right then: the IFIs or its critics? Is there any reason for optimism? In terms of what is *really* new, a relatively broad based consensus has at least emerged on the following two issues:

- IFIs today formally recognize the existence of political economic problems within recipient countries, recognizing that policy makers might not be completely benevolent. This is a rather recent development. Until the late 1980s, during the period of the Cold War, such problems may have been noticed but were rarely pointed out directly by either the IFIs or other donor organizations in order not to lose the political support of the governments concerned at the international level. The recognition of the political economy at this level is a relevant precondition for channeling the benefits of development co-operation to the poor.

- While broad based participation has long been preached by IFIs and other donor agencies, it has now become a formal requirement in the context of PRSPs. Since PRSPs have themselves become a precondition for almost all concessional financing, most of the multilateral and even bilateral development assistance is now effectively conditioned on participatory processes. At the same time, traditional conditionality based on economic policy has been largely removed (for the case of the HIPC initiative, see e.g. Michaelowa 2003). As the new requirements are based on processes rather than directly on policies, one may also speak of “process conditionality” (Foster et al. 1999).

It can be shown that both points are not independent from each other. Recognizing that various interests are involved in the local distribution of aid funds and that government are political actors with more complex objectives instead of simple welfare maximization, it becomes obvious that the weak position of the poor in the political negotiation and decision making process would need to be strengthened considerably if they were to benefit from development co-operation. Aiming at the empowerment of the poor through process conditionality can thus be considered as a logical consequence. This issue will be discussed in more detail in the following section.

### **3. THE RECIPIENT COUNTRY AND THE RELEVANCE OF PRSP PROCESSES**

Let us consider the situation in the framework of a more abstract politico-economic model.<sup>2</sup> We will first follow the traditional way of assuming that interest-based political processes are only relevant on the recipient side. Therefore a benevolent IFI offers loans or grants to enhance pro-poor growth in a developing country. We suppose that the IFI maximizes welfare in the world as a whole, i.e. in both donor and recipient countries.

The recipient government is taken to be non-benevolent and subject to influences from different local interest groups. It maximizes its chances to remain in power and its policy decisions therefore depend on their expected impact on the political support of the relevant groups in society. To simplify, we consider only two groups, the “rich” and the “poor” whose relevance for the government is obviously not the same. In well functioning democracies with a majority of poor people we would expect the weight of the poor to be relatively high, simply because they could mobilize a large number of voters. However, these circumstances are rather rare in developing countries. In most of the predominately African countries currently experiencing the PRSP processes, the rich tend to have the far greater relevance as a potential threat or support to the government. This is based on their proximity to government officials, their capacity to influence public opinion, and their capacity to challenge the prevailing power structure through economic, financial or military means. The weight governments attribute to the welfare of the poor in their political decision making process will therefore be rather small in most cases (Boone 1996, Drazen 2000).

This does not mean that all decisions will be taken against the poor. Let the government have a bundle of policy instrument, that we call “distortions”, which would hinder pro-poor growth. These distortions work to the benefit of the rich but to

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<sup>2</sup> A technical version of the model and proofs of the arguments lined out here can be found in Hefeker and Michaelowa (2003).

the detriment of the poor. Examples for this are distortive taxation, tariffs and quotas, or inflation that benefit the rich and hurt the poor. It is plausible to assume that the marginal utility of the rich decreases while the marginal disutility of the poor increases with increasing distortion. Then at some point, even though the poor have relatively little political weight, their suffering will become so strong that they become a political threat to the government. At the same time, if distortions are already high, additional distortions will bring only reduced support from the rich. The optimal policy for a government maximizing its chances to remain in office will then obviously be the level of distortions at which the increased additional threat through the poor just balances the additional support by the rich. This is the naturally prevailing “political equilibrium” in the recipient country.

In contrast to the government, the IFI does not undervalue the welfare of the poor and therefore considers this political equilibrium as being unacceptable. Its objective is to increase pro-poor growth by reducing distortions. To reach this objective it can use the instrument of development assistance which may be unconditional, conditioned on policies (traditional conditionality), or conditioned on PRSP processes (process conditionality). Let us consider these situations one by one.

### *Unconditional aid*

Can unconditional aid change the political equilibrium in the recipient country? Indeed, it can to the extent that the inflow of development funds interacts with the marginal utility or disutility of distortions. It appears plausible to assume that the negative impact of distortions for the poor becomes even stronger when aid is increased. That is, the negative effect increases in absolute terms. The reason is that with more funds available for pro-poor growth, the opportunity cost of distortions will increase. If, at the same time, the positive effect of distortions on the welfare of the rich decreases, development co-operation will automatically lead to reduced distortions and enhanced pro-poor growth (Mayer and Mourmouras 2002).

Unfortunately, aid funds can also be used to create additional rents from a given distortion (Boone 1996, Svensson 2000). This leads us to assume that the rich group’s marginal utility of distortions may increase rather than decrease with increasing development assistance. If the weight of the welfare of the rich in the government’s utility function is sufficiently high this will lead to a new political equilibrium at an even higher level of distortions than before. Even if the aid funds as such contribute positively to the welfare of the poor, the new level of distortions indirectly provoked by the inflow of these funds may outweigh this positive effect. This actually implies that unconditional aid can become counterproductive and be to the disadvantage of the poor.<sup>3</sup>

### *Aid conditioned on policies (traditional conditionality)*

To avoid this undesirable effect, IFIs have long tried to condition aid on particular policies, i.e. in the case of our model, on the level of distortions. The developing country government is generally interested to receive aid since both the rich and the poor benefit from it at a given level of distortions. This implies that any increase in

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<sup>3</sup> This result is consistent with the empirical studies on aid effectiveness by Burnside and Dollar (2000) and World Bank (1998).

aid will enhance political support for the government. In order to receive aid, the government is therefore ready to accept a certain reduction in distortions, even if this goes hand in hand with a loss of political support by the rich which cannot be fully compensated by the higher support of the poor. If the IFI knows the government's preferences, it can specify its development funds per level of distortions in a way that the government becomes just indifferent between the two options. This leads to an agreement between the IFI and the government that involves the maximum reduction in distortions compatible with the government's self interest.

Unfortunately, there is a serious problem with the reliability of the government's commitment. Once the IFI has delivered its financial assistance, the government has no more incentive to remain at the agreed level of distortions. In the absence of an effective enforcement mechanism, the IFI has no means to ensure compliance. In fact, the lack of compliance to formally agreed conditions was frequently observed and this even though aid was often delivered in tranches (see e.g. Hermes and Lesink 2001, p. 7; Morrissey 2001, p. 28; White and Morrissey 1997, pp. 500f. and 502f.).

What we observe, in other words, is a problem of lacking ownership: The government agrees to implement a certain policy because this is the only way it can obtain the aid funds, but it does not find this policy desirable as such.<sup>4</sup> Thus traditional conditionality is generally ineffective because there is no commitment by the recipient government.

#### *Aid conditioned on PRSP processes (process conditionality)*

To mitigate some of these problems, the IFIs have recently introduced "process conditionality" (Booth 2001, p. 3). While traditional conditionality focuses on outcomes, process conditionality focuses on "*processes*" (Foster et al. 1999) or "*actions*" (Dixit 2000). Developing countries are requested to initiate a broad based participatory process in order to elaborate their PRSPs if they want to receive financial assistance.

In order to analyze the effect of conditioning aid on these processes, we need to define what "broad based participation" could actually mean. As many other terms used in the context of development assistance, the meaning of this term is not very precise leading to different expectations by different people.

One problem is that it remains unclear what the condition of "participation" in PRSP processes means in terms of the potential range between full decision making power and simple information rights. Is it "participation" when civil society groups etc. are simply gathered and informed about the policies? Is it "participation" when they are involved in the debates, but without any binding commitment that their opinion will finally be taken into account by policy makers? Does "participation" require that the groups involved will finally take the decisions themselves?

Moreover, the term "broad based" is not an operational concept either. One interpretation frequently found in the aid community and reflected in the literature (Maxwell 2003, p. 15; Marshall and Woodroffe 2001, pp. 10f.; Morrissey 2001, p. 14)

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<sup>4</sup> For an interesting general discussion of the difficulties to reconcile conditionality and ownership, see Drazen (2001).

is that participation should be maximised, i.e. that all relevant stakeholders should be involved in the PRSP process. The idea is that only if all relevant stakeholders come together and reach a joint agreement on future policies, they will really own these policies so that the latter become sustainable

Unfortunately, this kind of “broad based participation” is simply not feasible. If taken seriously as a requirement to reach a consensus among all relevant stakeholders about a wide range of macroeconomic, social and institutional reforms of which some will benefit and others will lose, it is hard to imagine how this requirement could ever be met (Morrissey 2001, p.14). In countries without basic democratic structures even the selection of representatives is a considerable challenge. Because it is difficult to imagine that the IFIs are not aware of this problem, we believe that their interpretation of the “broad based participatory PRSP process” might actually be a different one.

One possible interpretation of the idea of PRSP processes is that more influence should be given specifically (and exclusively) to those groups who directly benefit from pro-poor growth. This interpretation implies that “broad based participation” does not include everybody, but only those who are the intended beneficiaries of policy reform.

A closer look into the World Bank’s PRSP Sourcebook reveals that IFIs have indeed relatively clear ideas about which groups to include and which groups to exclude from the discussion process. The choice is deliberately selective and there is no intention to include all. In the context of education sector reform, for instance, the Sourcebook suggests *“isolating or working around cost bearers or opposition groups such as teachers’ unions by building alliances with other stakeholders, such as parents and communities, school principals, and the business community”* (World Bank 2002, p. 270).

While an IFI prescribed preselection of the groups to be included in the participatory process appears to be at odds with the professed emphasis of the PRPS process to be “country driven”, this contradiction does not seem worse to us than in the case of economic policies in general. Economic policies as well are supposed to be developed by the recipient country, but it is clear that only policy proposals acceptable for the IMF and the World Bank will lead to the PRSP to be endorsed and the aid funds to be released.

If the government agrees to aid conditioned on the PRSP process, the selected groups can send their representatives to participate in discussions about the national poverty strategy with government officials, politicians and relevant civil servants as well as IFI representatives. Participation in these discussions increases the contacts of these groups, raises their opportunities for networking, and gives them access to the media. The result is an empowerment of the selected groups, which can be reinforced by additional measures such as alphabetization or courses on legal rights to help them take full advantage of their new opportunities.

The empowerment of some selected groups will obviously change the distribution of relative political powers in the recipient country. In terms of our model where only two groups are considered, this would imply that the interests of the poor become more important for the government. Once the poor have obtained more political



weight, the government will consider more favorably any policy that increases their welfare. Consequently, the government will now set a lower level of growth reducing distortions for any given level of development assistance.

If the participatory process is successful, the pro-poor policies are in the government's own interest which also solves the problem of lack of ownership. It should be noted that this is true despite the fact that the government would have never chosen these policies *ex ante*, before the aid inflow conditioned on the PRSP process led to the empowerment of the poor and thereby changed the political weights attributed to the two groups. However, if the government "owns" these policies *ex post*, this is sufficient to ensure the sustainability of reform.

Under the assumptions outlined above, conditioning aid on PRSP processes thus appears to be a relevant tool to enhance aid effectiveness for the poor. Moreover, it can be shown that IFIs can actually formulate policies in such a way that process conditionality leads to exactly the same result as traditional conditionality if it were enforceable (Hefeker and Michaelowa 2003, Figure 5).

Note that the interpretation of "broad based participation" being selective (as opposed to all inclusive) is crucial for the above result. If all competing groups experience the same promotion through the participatory process no specific empowerment of the poor will take place, their political weight will remain unchanged, and the overall political equilibrium will not be altered to their benefit. Similarly, if the government itself decides on whom to include into the process – a country driven approach in the purest sense – it has no incentive to change the existing weights, and chances to change the prevailing political equilibrium are minimal.

#### **4. THE DONOR SIDE**

We shall now relax the assumption that problems of political economy arise exclusively in the recipient country. The IFI is no longer representing the interest of the world as a whole. As suggested by Willet (2000), its policy preferences are biased by bureaucratic interest and public pressure through donor governments and international NGOs.

In a first step, we shall consider that international bureaucracies tend to behave as budget maximizers. In a second step, we shall analyze the influence of NGOs and bilateral donor governments.

##### *The IFI as a budget maximizer*

If the IFI has an interest in maximizing its budget, this implies that it needs to at least fully disburse the funds currently at its disposal. In fact, the disbursement of all available funds may even be a necessary condition for preserving the current budget and staff. It is therefore no surprise that the disbursement objective is frequently reported by observers of the aid business (e.g. Easterly 2002, Mosley 1996, Vaubel 1991).

If the IFI does not confine itself to the maximization of world welfare but simultaneously maximizes aid disbursements, this part of its interest will completely

coincide with the interest of the recipient government. This implies that effective development assistance will clearly be higher than before, a fact that will unambiguously enhance the recipient government's utility. As long as the poor are only weakly represented in the government's utility function, it cannot be excluded, however, that all benefits from more aid will be channeled to the rich while the poor are worse off than before. This is because – as discussed above – increasing aid (without enforceable conditionality) generally goes hand in hand with increasing distortions.

Conditioning aid on PRSP processes can again ensure that the benefits of the recipient government do not arise to the detriment of the poor. As the poor become more important for the considerations of the government, its preference for distortions becomes smaller and more aid may then even imply decreasing distortions. In this case, an increase in aid becomes unambiguously beneficial for the poor.

It should be noted that in the case of a budget maximizing aid bureaucracy, the IFI's and the recipient government's overall preferences coincide in their aims to disburse as much aid as possible. Bilateral donors therefore need to closely monitor the IFI's spending behavior and to define a budget constraint determining the maximum amount of aid the IFI can disburse.

We can conclude that under bureaucratic budget maximization, more aid will be disbursed while the general functioning of PRSP processes remains unchanged. As higher aid volumes are involved, it becomes even more relevant that these are spent to the benefit of the poor and do not lead to higher distortions. Taking into account bureaucratic budget maximization therefore strengthens the case for process conditionality.

#### *The IFI under external pressure*

So far we have assumed that the IFI knows who best represents the interests of the poor and uses PRSP processes to increase their weight in the recipient country's political process. In reality, however, the situation in developing countries is complex so that the best representatives of the poor might not always be easy to identify. There are often numerous groups claiming this role. All of them know that being able to participate in the PRSP process will increase their political influence and the attention the government will pay to their points of view.

Even within the donor community, there is generally no unanimity with respect to which groups should or should not be empowered in the context of PRSPs. International NGOs have often complained that local civil society organizations – often their own local partners – have not sufficiently been integrated into the discussions (see e.g. Marshall and Woodroffe 2001, pp. 10f.). Complaints by local groups whose intention to participate was declined are taken up by various interest groups in the donor countries as well as by external researchers. Even in the case of Uganda which is frequently cited as one of the most successful countries with respect to the implementation of the PRSP process, numerous groups are dissatisfied with their integration into the related discussions (Lister and Nyamugasira 2003, pp. 102f.).

Consider the above mentioned example of education sector reform. While the World Bank's PRSP Sourcebook reveals the Bank's firm position that teacher unions' influence is detrimental to the implementation of an efficient educational strategy, one might also argue that teacher unions are the most knowledgeable representatives of poor students' interests when to develop a policy of enhanced educational quality. It is almost certain that there will be at least one international NGO, such as an industrial country teachers' union with interests in development issues, that will lobby for the inclusion of teacher unions in the PRSP discussions.

Since poverty reduction is a multidimensional goal and there is even no consensus on what actually constitutes a pro-poor growth strategy (Morrissey 2001, p. 14; Klasen 2001, p. 1), it is easy for lobby groups of various backgrounds and interests to claim the relevance of their partners for an efficient poverty reduction strategy. Thus, like NGOs, commercial or political interest groups in donor countries may lobby for the inclusion of groups with whom they cooperate. Examples could be multinationals interested in exploiting resources in the developing country or firms that sell arms or luxury items to the rich "elites".

Moreover, it is conceivable that donors are influenced directly by the position of the recipient government. Given the difficulties to assess the political situation in (mostly far away) developing countries, political actors in donor countries, including both aid agencies and NGOs, might argue that the representatives of the poor can be determined correctly only within the recipient country itself. This argument seems to be well in line with the IFIs' own assertion that PRSPs should be fully "country driven". For simplicity, and because they lack other relevant channels of information about developments in the recipient country, donor governments may thus adopt their partner government's position. This will tend to stabilize rather than to change the prevailing power structures in the recipient country.

Even if the IFI knows the "real" representatives of the poor, it will tend to take into account the position of other relevant actors too. Permanent pressure from bilateral donor institutions or international NGOs could deteriorate the IFI bureaucrats' working climate. Moreover, in the long run, dissatisfaction of bilateral donors may lead to reductions in the IFI's budget. The IFI therefore has a strong incentive to integrate at least partly the positions of NGOs and bilateral donor governments into its own policy stance to avoid too much criticism and external pressure.

Interestingly, some observers of the PRSP process have noted that despite the rhetoric of "empowerment", IFIs themselves appear to be very reticent when it comes to a concrete description of political power structures or political mechanisms. They tend to prefer the technical and juridical arguments, even if the matter in case is purely political (Craig and Porter 2003). Technical advice is where they are supposed to have their comparative advantage and where bilateral donor governments on whom they depend financially expect them to excel. Bilateral donors would hardly accept debates with IFIs about purely political issues. This may increase the IFIs' readiness to accept bilateral donor and NGO positions with respect to the inclusion of different groups into the PRSP decision making process.

One might also argue that the IFI itself is not always sure of who are the real representatives of the poor. Alternatively, the IFI might be well able to find out the

right group to support, but this process might take more time than the IFI is willing to invest. There is ample evidence on “hurry-up lending” (Vaubel 1991) and rushed aid disbursements or debt forgiveness such as in the context of PRSP processes linked to the HIPC initiative (Michaelowa 2003, p. 472; Marshall and Woodroffe 2001, p. 10; Booth 2001, p. 18). Even the official IDA/IMF (2002, pp. 8 and 24) review of the PRSP approach acknowledges this problem. In all these cases, orienting the IFI’s policy at the bilateral donors’ position will at least provide it with some immunity against later criticism.<sup>5</sup>

What is the implication of all this for the effectiveness of process conditionality? Apparently, there exists a considerable risk to select the wrong representatives into the PRSP process. In the extreme case, if empowerment through participation is targeted to the rich instead of the poor, distortions in the new political equilibrium will be higher than before and higher even than in the case of unconditional aid. If the involvement of different groups follows the recipient government’s suggestions, no deviation from the already prevailing political situation can be expected at all. In both cases, aid will increase distortions. The IFI’s budget maximization behavior further exacerbates this problem. Targeting the true representatives of the poor and selecting those (and only those) into the PRSP process is crucial for the effectiveness of process conditionality for pro-poor growth.

## **5. CONCLUSIONS AND RECOMMENDATIONS**

While “pro-poor growth” cannot convincingly be presented as a new objective, formal conditioning of aid on the participation of the poor in the developing country’s political decision making process (process conditionality) is a truly innovative tool associated with current PRSPs. In developing countries whose governments do not sufficiently value the welfare of the poor, the effectiveness of this instrument depends on its capacity to alter the prevailing political equilibrium.

It turns out that if the IFI is benevolent, if it knows the right policy mix required to enhance pro-poor growth, if it also knows who represents the poor, and if it resists external pressure from bilateral donors and NGOs, it can indeed fruitfully use the new instrument and promote pro-poor growth. This result also holds if the IFI is not fully benevolent but seeks to maximize its own budget. In this case, aid disbursements are particularly high which further increases the relevance of conditioning aid on PRSP processes. All that needs to be done from the bilateral donors’ side is to monitor aid disbursements and to enforce certain budget limitations on the IFI.

If the IFI knows the policy mix required to enhance pro-poor growth and also knows the groups representing the poor, but does not resist external pressure, the situation becomes different. Rising distortions, reduced growth and a negative effect of aid on the poor cannot be excluded. If the empowerment induced by the PRSP process is ill-targeted, this may push the political equilibrium into the wrong direction. Since the IFI knows who should be promoted, but simply does not enforce its point of view against the bilateral donors’ position (or the one of international NGOs), it would be

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<sup>5</sup> Note that this pressure has probably increased in recent years, where several commissions have been active to investigate the role and function of IFIs (see Hefeker 2003). Since most tend to be quite critical of the IFIs, they have any incentive to try to please donor governments by taking their positions more strongly into consideration.

necessary to make the IFI more independent from these influences, e.g. by changing their governance or financing structure.

If the IFI does not have the relevant information, the situation is again different. As before, a negative effect of aid on the poor cannot be excluded. However, in this case the solution is not to increase the IFI's independence. To the contrary, the influence of external institutions with better knowledge should be strengthened. The problem is to find these. Can NGOs be expected to have a better understanding of the situation in recipient countries? This may be true in some cases, but certainly not in general. Developing country governments are certainly not the right "experts" to consider, either. It cannot be expected that they will reveal anything which would call for a move away from the already prevailing political equilibrium. Any impulse to change this equilibrium must be exogenous.

In some cases, the IFI may be able to acquire itself the relevant information through more thorough investigation. The IFI should then be encouraged to undertake this additional effort. What is most important are safeguards against "hurry-up lending" or "hurry-up disbursements" driven by the objective of budget maximization. Moreover, selectivity may help in the sense that PRSP processes should be started only in those countries where the necessary information to ensure that the political equilibrium is moved into the right direction is available.

Unfortunately, even these recommendations only represent partial solutions to the general problem. Moreover, they are case-specific and partly contradictory. It may be difficult to find out whether the IFI does not hold the necessary information or whether it does not put it forward due to external pressure. However, the consequences for the desirability of IFI independence would be just the opposite.

All in all, it appears that under realistic assumptions, aid conditioned on PRSP processes will not necessarily be effective in terms of pro-poor growth, and may even become counterproductive. This rather pessimistic scenario suggests that Easterly (2002) might be right: With the "new" objective of "pro-poor growth" and the instrument of PRSPs, the aid community has again announced a considerable and innovative reform, but unfortunately, chances for significantly improved results still remain very limited.

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